Another critical LEC bottleneck is the telephone numbering system and the inability of customers to retain their existing number if they wish to change carriers. Customers have made clear that they are very reluctant to use new carriers if this would require them to change their telephone number(s). Although several LECs have begun to discuss service arrangements that allow some degree of telephone number retention, these arrangements generally impose substantial costs on new entrants, both through direct charges for use of the number retention service and loss of revenue opportunities. The nationwide telephone numbering and routing systems implemented by the Bell System in the 1950s are based entirely on six-digit screening (*i.e.*, calls are routed based on the three-digit area code (NPA) and the three-digit central office code (NXX)). These systems require that any call dialed with a particular NPA-NXX combination be routed to the end office to which that combination is assigned. Although it is technically possible for the call to be forwarded from that assigned end office to a different destination, the incumbent LEC typically demands not only that it collect a terminating access charge for routing the call to the assigned end office, but also that it receive further compensation for forwarding the call to the new provider. This imposes a double cost on the new entrant, since the opportunity to collect a terminating access charge to recover the cost of terminating the inbound call is lost, and additional costs are incurred for the forwarding of the call. Given the importance to customers of retaining existing telephone numbers, these added costs create a substantial impediment to competitive entry.

Given these barriers to entry in their largest market segments, LECs will also continue to enjoy substantial economies of scale and scope in those limited market niches that are beginning to face competition. As long as no other carrier can offer the full range of services that the LECs do, no potential competitor can obtain the same level of facilities utilization or achieve other economies of scale available to the LECs. These advantages, needless to say, are not due to any superior skill or efficiency of the LECs, but rather result from their ability to exclude competitors from most of their markets.

For the reasons stated in the previous section, the Commission should examine whether a LEC is subject to competition for *all* services in a given geographic market, not on a service-by-service basis. As the foregoing discussion makes clear, the removal of barriers to entry, either by eliminating LEC bottlenecks or by establishing regulatory ground rules that assure all competitors of equal access to the bottlenecks, is a necessary (although not sufficient) condition for the existence of effective competition in a geographic market. Once these bottlenecks are opened to competitors, the Commission should require a showing that competitive services are actually available on a widespread basis throughout the geographic area (not merely "potentially" available).[66] It is neither necessary nor realistic to require that competitive services be available to 100% of customers before allowing pricing flexibility for the LECs; however, it would be equally

[66] By "competitive" services, MFS means services that consumers in fact view as comparable substitutes for all services offered by the LECs. The fact that an alternative to a given service is *technically* available does not make it "comparable" in an economic sense; for example, cellular services are technically capable of providing local dial tone and local exchange calling today, independent of LEC networks, but their technical and economic characteristics prevent them from being a reasonable substitute for basic LEC service for most customers. "Comparability" is a question of fact to be determined by consumer behavior and preferences.

unrealistic to declare a market "competitive" before most customers have the ability to purchase competitive services.

MFS believes that the best way to identify "competitive" markets, after the removal of entry barriers, would be to measure both the percentage of customers who have competitive services available *and* the percentage actually subscribing to such services. When both of these measures pass certain predetermined thresholds (*e.g.*, available to 50% of customers and actually used by 15% of customers), the Commission could presume that competition is firmly established in the market in question and that greater pricing flexibility for the LECs would then be justified.

Nonetheless, MFS recognizes that a "market share" test is subject to criticism on administrative grounds, since the Commission lacks the tools for precisely measuring service availability and market share in thousands of exchange markets throughout the country. In addition, LECs frequently complain that they should not be forced to lose a specific level of market share before being allowed to price competitively, although this argument should be given little weight since the LECs already have a considerable degree of pricing flexibility.

Because of these concerns, MFS proposes that the Commission allow pricing flexibility when structural conditions for competitiveness have been satisfied (*i.e.*, removal of legal and economic barriers to entry), *and* a sufficient amount of time has passed to permit competitors to deploy facilities and market their services to customers in the new market area. This approach would avoid the need for the Commission to examine market share, or for the LECs to demonstrate that competitors had captured a predetermined level of revenues.

MFS proposes that the Commission rely upon state regulators to determine when the conditions necessary to permit competition exist within a particular LEC study area. State regulators are in the best position to make this assessment because, as noted above, most of the LECs' services are under their jurisdiction. Under current law, only the states can take the necessary actions to open LEC local services to competition and interconnection, and to regulate the terms of interconnection for local services to assure an open marketplace.[67] The Commission should establish a process by which any LEC study area can be classified as "open to competition" when the state regulator formally certifies to the Commission that all of the following conditions exist:

1. One or more carriers have obtained certification (or the equivalent under state law) to provide all forms of intrastate telecommunications services in competition with the incumbent LEC (or, no such certification is required under state law); and competitive services are actually being offered by one or more such carriers within the study area.

2. Competitive carriers offer services that are comparable in type, quality, and price to the incumbent LECs' basic local exchange services. (*See* note ?, *supra.*)

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[67] Some legislative proposals currently pending in Congress, however, would enact federal standards with respect to local competition, which would have to be implemented either by this Commission or by the states. *See* National Communications Competition and Information Infrastructure Act of 1993, H.R. 3636; Communications Act of 1994, S. 1822.

3. Municipalities and state agencies are prohibited from imposing different or greater fees on new entrants for franchises and access to public rights-of-way and other government-owned facilities than they impose on the incumbent LEC.

4. The incumbent LEC is required to provide competitive local exchange providers with pole attachments, conduit space, and access to building entrance facilities and LEC-owned cable inside multi-tenant buildings at reasonable, non-discriminatory, and compensatory rates.

5. The state requires the incumbent LEC to interconnect with other providers of local exchange service on equitable and reciprocal terms that include, at a minimum, the following requirements:

a. Competitive carriers should be entitled to assignment of NXX codes and other number resources on the same basis as the incumbent LEC;

b. Incumbent providers and new entrants should be required to establish connecting trunks between their respective networks. These connections should achieve transmission, signalling, and quality characteristics which are comparable to the characteristics which exist within each carrier's own network. The connections should occur in sufficient quantity and at locations appropriate to ensure efficient, reliable transmission of traffic, without requiring either carrier to unreasonably deploy facilities or route traffic.

c. Incumbent LECs and new entrants should be required to exchange signalling information using Common Channel Signalling ("CCS") to one another in conjunction with all interconnecting trunk groups. With CCS, caller identification information should be exchanged, all privacy indicators should be honored, and the carriers should cooperate on the exchange of all other messages to facilitate CCS/ CLASS-based services. CCS transport facilities should also be provided under meet-point arrangements (at established co-carrier meet-points), with no transport facility or transport termination charges applying to either party. For traffic for which CCS is not available, in-band multi-frequency ("MF") signalling should be provided.

d. Each carrier should engineer its portion of the interconnection facilities in sufficient quantity to achieve the same grade and quality of service between its network and the other carrier's network as it provides within its own network for similar interoffice facilities, or that it provides on facilities that connect its network to adjacent LEC networks, and at least equal to Feature Group D. Each carrier should provide the same standard of maintenance and repair service for their respective portions of the interconnection trunks as they do for their own trunks.

e. Calls originating on one provider's network and terminating on the other's within a local calling area should be completed using the same dialing patterns, and without substantially different post-dial delay, as calls originating and terminating on the incumbent's networks.

f. Each local carrier should be entitled to impose charges for access to its network by other carriers. Reciprocal termination should be offered on terms that allow each participating carrier a reasonable opportunity to recover its own costs. Carriers should not be permitted to impose termination charges in excess of direct costs plus a reasonable mark-up to recover shared and common costs, except as specifically directed by the state commission to fund universal service or other public policy goals.

g. Local carriers should be required to enter into mutual billing and collection agreements so that each provider can accept the other's calling cards, and can bill collect or third-party calls to a number served by the other provider. Both carriers should also be required to provide the other with access to line information and directory assistance databases so that the other carrier can verify that collect and third party calls are permitted to a particular number, can validate calling cards and can offer directory assistance on a competitive basis.

h. Customers must be able to change local carriers (at the same geographic location) without changing their existing telephone number. Telephone number retention must not prevent the new entrant from recovering its access charges for termination of calls on its network. The incremental cost of service arrangements required for local number retention should be recovered on a non-discriminatory basis from *all* users of telephone number resources (not solely from customers of the new entrant), because the availability of telephone number portability and the resulting introduction of competitive options will benefit all users.[68]

Once a market has been declared as "open" to competition by meeting the criteria listed above, the Commission should introduce LEC pricing flexibility on a staggered

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[68] This is analogous to the approach by which the costs of equal access implementation were recovered from all IXCs, not merely from the new entrants. Although equal access allowed the new entrants to compete, *all* users (including customers of the former monopoly interexchange carrier) benefitted from the introduction of competition and choice, so it was appropriate for all users to share this cost.

schedule in order to permit time for competitors to install facilities and advertise and market services, thereby assuring a reasonable likelihood that competitive services will actually be available on a reasonably widespread basis when LEC pricing flexibility takes effect. MFS proposes the following schedule:

1. LEC downward pricing flexibility would take effect immediately in the Zone 3 (low density zone) central offices within an "open" study area, and in all central offices in any study area where zone pricing is not in use. This flexibility would permit LECs to respond to possible "cherry-picking" of the one or two large customers in predominantly rural portions of their service areas.

2. LEC downward pricing flexibility would take effect after 12 months in the zone 2 central offices.

3. Full LEC pricing flexibility in all central offices would take effect 24 months after a study area is certified as "open."

MFS respectfully submits that the criteria suggested above will permit the LECs a reasonable opportunity to compete if and when meaningful competition actually develops in their markets, while protecting captive ratepayers against the potentially harmful consequences of premature deregulation.

Transition Issue 1c: In what circumstances will a LEC no longer control essential "bottleneck" facilities for some or all of its services?

As described under Transition Issue 1b, above, LEC "bottlenecks" are pervasive and multi-faceted. It is simply fanciful to expect that all of these bottlenecks, such as the preferential access to private property granted to the LECs because of their status as "the telephone company," or the fundamental nature of the telephone numbering plan, will cease to exist at any time in the foreseeable future.

Realistically, the only way to assure meaningful competition is for the Commission, or state regulators, to maintain a sufficient degree of regulation to assure that LECs do not derive a market advantage from their control of bottleneck resources. This requires making access to the bottlenecks available to competitors on terms and conditions, including price, such that competitors and incumbents incur the same costs and burdens for use of the bottleneck resources. Regulation of access to bottleneck facilities must continue even after a market is declared "competitive"; indeed, that is when such regulation will be most urgently required.

In particular, effective local number retention that does not impose cost penalties on new entrants is an essential requirement for local competition. Even if *all* legal barriers to entry are removed and competitors have the same access to *all* physical facilities and resources as do incumbents (which is far from a realistic assumption), the lack of local number retention alone could prevent effective local exchange competition from developing. Competitive entrants must be able to offer local number retention to their customers without forfeiting revenues or incurring additional costs as a result. Any incremental network costs attributable to number retention should be recovered from *all* users of the telephone network, not only those users who choose to be served by new entrants.[69]

Similarly, the Commission will have to continue to oversee the rates and terms on which LECs provide access to their physical bottleneck facilities, such as pole attachments, conduit space, and expanded interconnection in central offices. These facilities cannot reasonably or economically be duplicated by competitors, even if duplication were technically or legally possible.[70]

Transition Issue 1d: What ability do CAPs and others have to compete with the LECs?

As the discussion of the previous issues should make clear, CAPs currently are unable to compete effectively for the full range of LEC services. Only three states (New York, Maryland, and Washington) have authorized full competition in the provision of basic local exchange services, and none of these states has yet fulfilled all the conditions for creation of meaningful competitive opportunities, such as establishment of reciprocal and cost-based interconnection policies and equalization of franchise obligations.[71] Only a few other states (Michigan, Illinois, Pennsylvania, and Massachusetts) are actively examining similar issues at this time. Thus, in most of the country, there is no reasonable

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[69] *See* note 68, *supra.*

[70] In many localities, environmental and aesthetic concerns have led state or local governments to restrict the construction of above-ground poles and to limit street openings for construction of subterranean conduits, so that use of LEC or other existing utility facilities is the only available option for a new entrant.

[71] New York and Maryland are both considering many of these issues in pending regulatory proceedings, however.

possibility that CAPs will be able to offer a full range of competitive services within the foreseeable future, although there is some possibility that potentially competitive conditions may emerge in certain specific states within a year or two.

In the absence of state action to remove barriers to entry in basic local exchange service, CAP competition is limited to narrow and specialized market niches such as high-capacity dedicated transport services. For the reasons discussed under Transitional Issue 1a, above, such niche competition does not significantly limit LEC market power and therefore does not justify any further pricing flexibility under current conditions.

Although the *Notice*, para. 95, suggests that "CAPs' profit levels, stock price trends, revenues, or other measures" may "reflect the CAPs' ability to compete," these data by themselves would provide little useful information. At most, these measures would only indicate CAPs' *potential* to enter the market if and when barriers to entry are eliminated. Not even the most well-financed and profitable corporation could compete against a LEC effectively if legally prohibited from doing so, or if denied access to LEC bottleneck facilities and technical resources such as number assignments.

Therefore, the Commission should give little weight to CAP size or financial characteristics in seeking to measure the potential for effective competition in LEC markets.

Transition Issue 2: What regulatory methods for reducing price cap regulation or streamlined regulation should be adopted for LEC services as those services become subject to greater competition?

MFS has discussed under Transitional Issue 1b, above, the conditions under which it believes greater LEC pricing flexibility would be appropriate. In this section, therefore, it will specify what particular forms of pricing flexibility would be appropriate once those conditions are satisfied and the necessary time for the introduction of widespread competition has elapsed.

Under existing price cap rules, LECs have almost unlimited *downward* pricing flexibility as a result of their ability to propose below-band rates. The only restriction is that such rates must not be predatory, and the Commission clearly should not modify that restriction if markets become more competitive. Also, LECs are prevented from increasing other prices to make up revenue lost through below-band pricing; in competitive markets, it is equally important to prevent such offsetting rate increases on services offered outside of the competitive market area. On the other hand, it is unlikely that the LECs would either need or desire added *upward* pricing flexibility in more competitive markets, since competitive pressures would limit their ability to increase rates in any event.

Thus, the major remaining restriction on LEC pricing flexibility is the requirement that rates be averaged throughout a study area or, for certain services, within each density zone. The requirement of averaged rates is crucial to the prevention of unreasonable discrimination in non-competitive markets. In a fully competitive market, however, market forces are likely to restrain unreasonable discrimination, since a victim of discrimination could simply switch its business to another carrier. Therefore, deaveraged pricing, including customer-specific pricing, would be far less troublesome under conditions of full, effective competition.

As the Commission is well aware, MFS has long been an opponent of customer-specific pricing by LECs. MFS remains strongly opposed to any relaxation of this critical safeguard against unreasonable discrimination under current market conditions. Nonetheless, MFS does acknowledge that market conditions can change, and that if and when they do, regulations that today are necessary may become unnecessary restraints upon competition. Therefore, MFS is prepared to accept full LEC flexibility to engage in customer-specific pricing, *after* the necessary conditions for full local competition outlined under Transitional Issue 1b have been satisfied and a reasonable opportunity for the entry of widespread competition has been provided (through the timetable proposed by MFS).[72]

Transitional Issue 3: Whether and how the Commission should schedule revisions in the composition of price cap baskets as local exchange access competition develops.

Under the approach outlined by MFS under Transitional Issues 1b and 2, pricing flexibility would be triggered simultaneously for *all* LEC services (except for specifically identified bottleneck elements) within a particular study area or density zone, once the

[72] However, even in competitive markets, full pricing flexibility should not apply to specific bottleneck rate elements that competitors must pay for access to the LEC network, including expanded interconnection rates and the Transport Interconnection Charge.

conditions for competitive entry had been satisfied. Under this approach, there is no need for realignment of price cap baskets, since all baskets will be opened to streamlined regulation at the same time.

Conclusion

As the Commission begins to contemplate a transition from monopoly to competition in the provision of basic local exchange services, it should recognize that careful regulatory oversight of the dominant carriers is at least as important *during* the transition as it was during the era of pure monopoly. The changing market conditions faced by the LECs mean that the greatest risk the Commission will face over the next several years is not excessive earnings or excessive overall rate levels (although these concerns have not entirely vanished, they are being addressed reasonably well by existing rules), but rather the use of highly selective and unduly discriminatory rates to give the LECs an unwarranted and anti-competitive advantage in narrowly-targeted, emergingly competitive market segments.

The Commission should therefore adopt the "baseline" changes in its price cap plan proposed above by MFS, including (1) adoption of a cost consistency requirement for the trunking basket, in lieu of the current scheme of pricing categories, subcategories, and multiple overlapping subindexes; (2) increasing scrutiny of potential discrimination, cross-subsidy, and anti-competitive impacts in new service tariff filings; and (3) adopting Total Service-Long Run Incremental Cost as the basic standard for cost analysis of LEC rates, in lieu of the current average variable cost standard.

In adopting "transition" rules for future changes to the price cap regime as markets become more competitive, the Commission must initially recognize that no real competition exists today in the LECs' most important markets, nor will it develop overnight. Transition rules should take effect only when conditions exist that will permit the development of widespread competition for *all* LEC services, including basic local exchange service, throughout particular geographic markets. Only when the LECs face competition in all services will their ability to engage in unreasonable discrimination and cross-subsidization of competitive offerings be significantly constrained by market forces. Once these conditions do exist, however, as evidenced by the formal determination of the state regulatory commission, the Commission should permit LECs greater pricing flexibility following a transition period to permit competitors to enter the market.

Respectfully submitted,

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